

**Limited Interagency Coordination and Insufficient
Controls over U.S. Funds in Afghanistan Hamper U.S.
Efforts to Develop the Afghan Financial Sector and
Safeguard U.S. Cash**



July 20, 2011

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OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR AFGHANISTAN RECONSTRUCTION

July 20, 2011

Executive Departments and Agencies:

This report discusses the results of a performance audit of U.S. efforts to improve the capacity of the Afghan government to regulate the financial sector and to strengthen the controls that U.S. agencies use to track U.S. funds as they flow through the Afghan economy. This report includes one recommendation to the U.S. Ambassador to Afghanistan to improve interagency coordination on financial sector development programs and three recommendations to the Secretary of State and the Secretary of Defense to strengthen oversight over the flow of U.S. funds through the Afghan economy.

When preparing the final report, we considered comments from the U.S. Embassy in Kabul, USAID, and DHS, which generally concurred with the report's recommendations. These comments are reproduced in appendices II-IV, respectively.

A summary of this report is on page ii. This performance audit was conducted by the Office of the Special Inspector General for Afghanistan Reconstruction under the authority of Public Law No. 110-181, as amended; the Inspector General Act of 1978; and the Inspector General Reform Act of 2008.

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Acting Special Inspector General
for Afghanistan Reconstruction

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SIGAR

Special Inspector General for Afghanistan Reconstruction

SIGAR Audit-11-13

July 2011

Limited Interagency Coordination and Insufficient Controls over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash

What SIGAR Reviewed

Since 2002, Congress has appropriated more than \$70 billion to implement security and development assistance projects in Afghanistan, with some of those funds converted into cash and flowing through the Afghan economy. The United States is implementing programs to increase the capacity of Afghanistan's central bank (Da Afghanistan Bank, or DAB) to regulate the nation's 17 commercial banks and to strengthen U.S. and Afghan law enforcement agencies' oversight over the flow of funds through the Afghan economy. This report (1) evaluates U.S. efforts to improve the capacity of the Afghan government to regulate the financial sector (which includes commercial banks and informal financial organizations, or hawalas) and (2) assesses the controls that U.S. agencies use to track U.S. funds as they flow through the Afghan economy. To accomplish these objectives, we reviewed Afghan laws and U.S. policies, plans, and progress reports relevant to U.S. financial sector development initiatives. We met with officials from the Departments of State, Homeland Security (DHS), Treasury, Defense (DOD), and the U.S. Agency for International Development (USAID). We conducted our work in Washington, D.C., and Kabul, Afghanistan, from October 2010 to July 2011 in accordance with generally accepted government auditing standards.

What SIGAR Found

Although U.S. agencies reported some progress in strengthening the Afghan government's ability to regulate its financial sector, two challenges prevent U.S. programs from fully achieving their intended results. First, U.S. agencies have not fully coordinated the implementation of their efforts. For instance, a key interagency working group did not include all U.S. agencies involved in implementing financial sector development programs. Additionally, DOD and DHS officials have not coordinated their work with the same commercial banks. Limited interagency coordination puts U.S. agencies at risk of working at cross-purposes or, at a minimum, missing opportunities to leverage existing relationships and programs. Second, Afghan ministries have not cooperated consistently with the United States, thereby delaying U.S. programs or preventing them from succeeding. For instance, Treasury reported that its programs to strengthen the Afghan government's ability to identify financial crimes have had limited results because of Afghan officials' reluctance to prosecute some cases. Additionally, because of disagreements between the U.S. and Afghan governments, the Afghan government has banned U.S. government advisors from working at DAB. Without full cooperation from the Afghan government, U.S. financial sector development efforts are limited.

While U.S. agencies have taken steps to strengthen their oversight over U.S. funds flowing through the Afghan economy, they still have limited visibility over the circulation of these funds, leaving them vulnerable to fraud or diversion to insurgents. First, U.S. agencies do not record the serial numbers of cash disbursed to contractors and other recipients. Second, commercial banks do not record the serial numbers of electronic payments made by U.S. agencies to contractors and other recipients when their electronic payments are converted into cash. Third, U.S. contracting regulations neither prohibit prime contractors from using unlicensed hawalas to pay subcontractors nor require them to use banks capable of handling electronic funds transfers. These vulnerabilities limit the U.S.'s ability to track information on U.S. funds as they enter and circulate through the Afghan economy – information that could be important for law enforcement purposes.

What SIGAR Recommends

Our draft of this report included a recommendation that the members of the Financial Sector Working Group include DHS in their planning meetings. In commenting on a draft of this report, the U.S. Embassy in Kabul, USAID, and DHS provided documentation that all U.S. agencies involved in implementing financial sector development programs are now included in the key interagency working group. As a result, SIGAR deleted the recommendation. SIGAR is making one recommendation to the U.S. Ambassador to Afghanistan to improve interagency coordination on financial sector development programs and three recommendations to the Secretaries of State and Defense to strengthen oversight over the flow of U.S. funds through the Afghan economy. The U.S. Embassy in Kabul agreed to take some steps to implement the recommendations, but also noted continuing challenges to financial sector development in Afghanistan. DOD chose not to comment on this report.

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ACRONYMS

AIB	Afghanistan International Bank
AML/CFT	Anti-Money Laundering/Countering the Financing of Terrorism
ANSF	Afghan National Security Forces
ATFC	Afghan Threat Finance Cell
ATM/POS	Automatic Teller Machine/Point Of Sale
ARTF	Afghanistan Reconstruction Trust Fund
CENTCOM	U.S. Central Command
DAB	Da Afghanistan Bank
DHS	Department of Homeland Security
DOD	Department of Defense
EFT	Electronic Funds Transfer
EGGI	Economic Growth and Governance Initiative
FAIDA	Financial Access for Investing in the Development of Afghanistan
FinTRACA	Financial Transactions and Reports Analysis Center of Afghanistan
GAO	Government Accountability Office
IMF	International Monetary Fund
ISAF	International Security Assistance Force
SIGAR	Special Inspector General for Afghanistan Reconstruction
SY	Solar Year
TFBSO	Task Force for Business and Stability Operations
USAID	U.S. Agency for International Development
USFOR-A	U.S. Forces-Afghanistan



Limited Interagency Coordination and Insufficient Controls over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash

In 2002, Afghanistan did not have an active banking system. With support from the U.S. government and other donors, the country reestablished its central bank (Da Afghanistan Bank or DAB), which, as of August 2010, was responsible for regulating 17 commercial banks with about 320 branches throughout Afghanistan. However, DAB's oversight and regulatory operations are not yet fully developed, many of the commercial banks lack basic capabilities, and the Afghan population continues to rely heavily on cash transactions through informal networks, known as hawalas.¹ Moreover, Afghanistan's financial sector faced a significant crisis in September 2010, when Kabul Bank (Afghanistan's largest commercial bank) nearly collapsed after news of alleged fraud and corruption at the bank led to a run on deposits.

The U.S. government has an interest in addressing these weaknesses, both to reduce the risk that U.S. funds are used for fraudulent purposes or diverted to insurgent networks and to help the Afghan government develop the financial capacity to support sustained development—a key reconstruction goal. As a result, U.S. agencies, particularly the U.S. Agency for International Development (USAID) and the Departments of the Treasury (Treasury), Defense (DOD), and Homeland Security (DHS) have implemented programs to develop the Afghan government's capacity to regulate the financial sector and strengthen controls over U.S. funds. This audit (1) evaluates U.S. efforts to improve the capacity of the Afghan government to regulate the financial sector and (2) assesses the controls that U.S. agencies use to track U.S. funds as they flow through the Afghan economy.

To accomplish these objectives, we reviewed Afghan laws, and U.S. policies, plans, and progress reports relevant to U.S. initiatives to improve the Afghan government's capacity to regulate the financial sector and to strengthen oversight over U.S. funds as they flow through the Afghan economy. We met with officials from the Department of State (State), DHS, Treasury, and DOD, as well as USAID and various officials at DAB. We also observed a meeting of an interagency working group focused on financial sector issues. We conducted site visits at the Kabul International Airport and various offices of DAB. We conducted our work in Washington, D.C. and Kabul, Afghanistan from October 2010 through July 2011, in accordance with generally accepted government auditing standards. Appendix I includes a discussion of our scope and methodology.

¹ Hawala dealers are individuals engaged in an informal money transfer system common in the Middle East and South Asia.

BACKGROUND

U.S. funds enter the Afghan economy primarily through disbursements to contractors and salary payments to Afghan civil servants.

- **Disbursements to contractors and other entities:** DOD, State, and USAID² obligate funds to contractors and other entities to implement contracts, grants, and cooperative agreements for reconstruction in Afghanistan.³ U.S. agencies rely on civilian contractors or other recipients to provide supplies and services in support of contingency operations and reconstruction programs in Afghanistan. U.S. Forces-Afghanistan (USFOR-A) serves as the command and control headquarters for U.S. Forces operating in Afghanistan.⁴ Its responsibilities include overseeing all DOD contractors in Afghanistan and managing, coordinating, and monitoring DOD contractors throughout Afghanistan through its major subordinate commands and liaisons with civilian agencies (such as State and USAID). USFOR-A's Financial Management Center provides technical oversight of all theater finance operations, including negotiating with commercial banks on expanding their use of electronic payments.
- **Salary payments to civil servants and Afghan National Security Forces (ANSF) personnel:**⁵ As of February 2010, State and USAID provided about \$7.9 million in payments to support the salaries of at least 900 Afghan civil servants. Under this initiative, the U.S. government makes contributions directly to DAB, which transfers the funds to the Afghan Ministry of Finance for payment. Additionally, the Law and Order Trust Fund for Afghanistan, an international trust fund managed by the United Nations Development Programme, pays for salaries, allowances, and other benefits of Afghan National Police personnel. Using this trust fund, the United States and other international donors have contributed almost \$1.5 billion since 2002 to support the salaries of as many as 125,000 personnel.⁶

U.S. agencies typically use two mechanisms to pay contractors and other entities and Afghan civil servants—electronic funds transfer (EFT) or cash payments, either in U.S. dollars or Afghanis.⁷ The U.S. government also supports a pilot program to deliver salaries to Afghan National Security Forces

² While other U.S. agencies have awarded contracts in Afghanistan, Congress has appropriated the majority of funds for reconstruction in Afghanistan to DOD, State, and USAID. As a result, we focused on these three agencies for the purposes of this report.

³ We previously reported that between fiscal year 2007-2009, DOD, State, and USAID obligated as much as \$17.7 billion to contractors and other entities based in the United States or Afghanistan. Funds may be disbursed to bank accounts based in the United States, in which case they may not directly enter the Afghan economy. Other disbursements are made directly into Afghan bank accounts, where they enter the Afghan economy. Data on total disbursements entering the Afghan economy directly are not available. See SIGAR Audit-11-4, *DOD, State, and USAID Obligated Over \$17.7 Billion to about 7,000 Contractors and other Entities for Afghanistan Reconstruction During Fiscal Year 2007-2009* (Washington, D.C.: October 27, 2010).

⁴ U.S. command structure in Afghanistan has evolved over time. To perform its military missions around the world, DOD operates geographic combatant commands that conduct activities within assigned areas of responsibility. Combatant commanders oversee U.S. military operations that take place within their area of responsibility. In Afghanistan, American forces fight as part of the International Security Assistance Force (ISAF), a multinational strategic unit. The Combined Joint Task Force, which was subordinate to ISAF, was responsible for the command and control of operations throughout Afghanistan. In 2009, the U.S. troops' designation became U.S. Forces-Afghanistan. USFOR-A develops strategies and priorities for U.S. operations in Afghanistan.

⁵ We completed two audits related to U.S. salary support provided to Afghan civil servants. See SIGAR Audit-11-5, *Actions Needed to Mitigate Inconsistencies in and Lack of Safeguards over U.S. Salary Support to Afghan Government Employees and Technical Advisors* (Washington, D.C.: October 29, 2010) and SIGAR Audit-11-10, *Despite Improvements in MoI's Personnel Systems, Additional Actions are Needed to Completely Verify ANP Payroll Costs and Workforce Strength* (Washington, D.C.: April 25, 2011).

⁶ U.S. agencies provided about \$441 million to this fund through September 30, 2010.

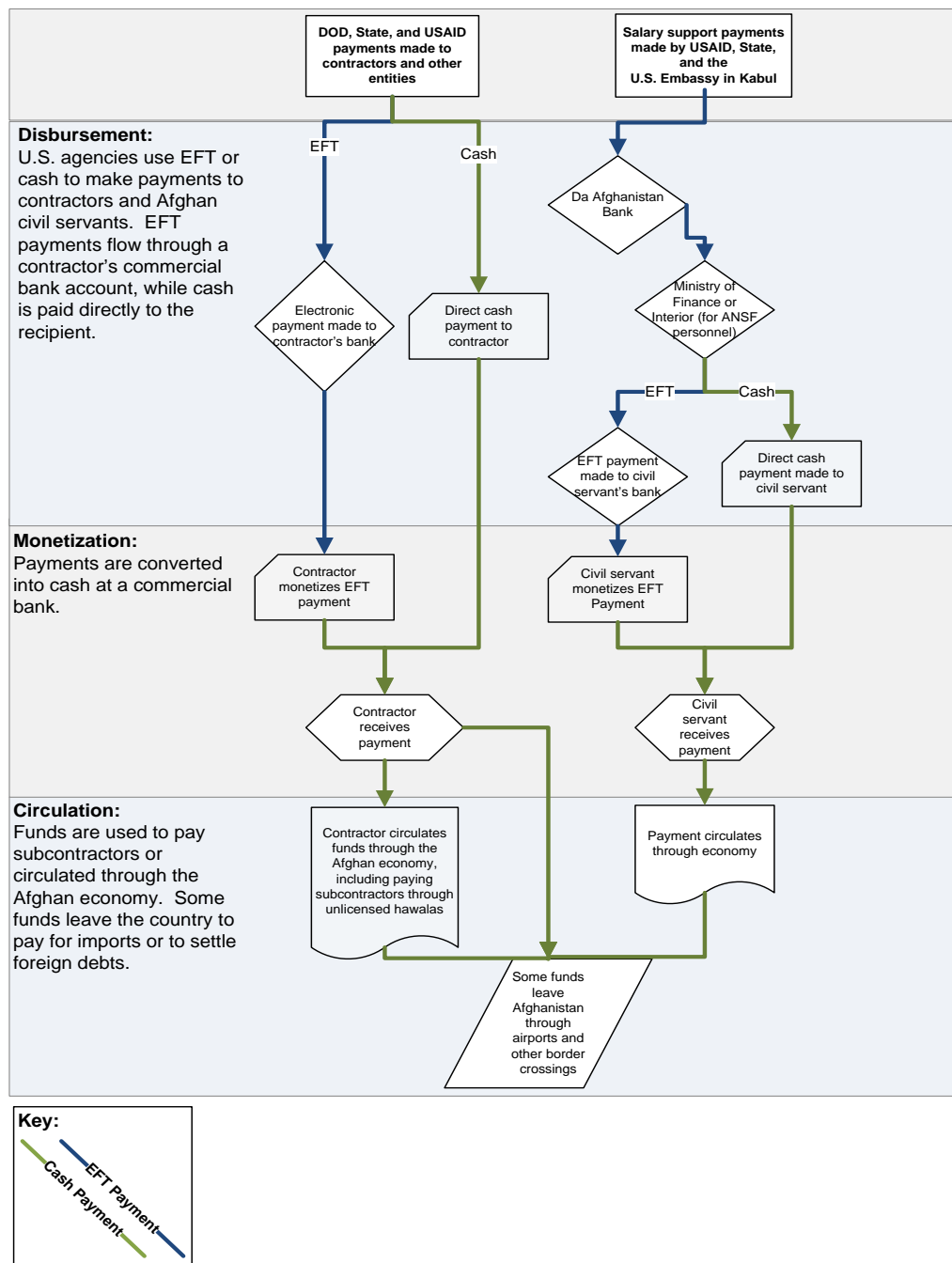
⁷ The Afghani is the official currency of Afghanistan.

personnel through mobile phones. In an EFT payment, funds are electronically transferred from the U.S. Federal Reserve Bank, via Citibank to either DAB, Alfalah Bank (a Pakistani bank with a Kabul branch), or Afghanistan International Bank (AIB), which then transfers the funds directly into the vendor's bank account.⁸ DOD and State also make payments to contractors in cash whereby payment officials disburse cash directly to vendors. When USAID and State pay Afghan civil servants, they do so by making EFTs to DAB, which are forwarded to the civil servant either in cash or via an EFT through the Afghan Ministries of Finance or Interior. Fifty-six percent of Afghan civil service employees and nearly 80 percent of Afghan National Police personnel receive their salaries electronically.

According to U.S. officials, U.S. funds typically flow through the Afghan economy in three phases. First, DOD, State, and USAID disburse funds to recipients, either through an EFT or in cash. Once an EFT payment is made, contractors and other entities or civil servants convert the electronic payment into cash at a commercial bank, a process known as monetization. Because Afghanistan's economy is cash-based, these recipients typically purchase raw materials or pay subcontractors in cash. Finally, contractors, subcontractors, and civil servants circulate funds through the Afghan economy using EFTs, cash, or hawalas to transfer funds between individuals. Afghans depend heavily on hawalas to transfer money within Afghanistan and abroad. In a typical hawala transaction, cash is transferred from one person to another through a network of trusted agents, who have representatives in the locations where money is being sent and received. For example, a prime contractor or another recipient that receives U.S. funds may use a hawala dealer to make payments to its subcontractors in remote areas. Figure 1 shows how U.S. funds enter and flow through the Afghan economy.

⁸ A formal partnership was formed between Citibank and AIB in September 2010, which established AIB as the predominant intermediary Afghan commercial bank to transfer DOD vendor payments.

Figure 1: Mechanisms Used by U.S. Agencies to Make Payments to Contractors and Afghan Civil Servants



Source: SIGAR analysis of information provided by State, Treasury, DOD, and DHS.

Note: Figure shows payments made through Afghan banks. U.S. agencies also make payments through U.S. banks, but these payments do not directly enter the Afghan economy and are, therefore, not depicted in this figure. As we note elsewhere in this report, USAID does not make cash payments to recipients.

Because of the level of corruption in Afghanistan and the continuing insurgency, the U.S. government's lack of visibility over its funds is a significant concern. Reports of as much as \$10 million a day in cash leaving the Kabul International Airport have added to these concerns. Treasury officials reported that about \$1.3 billion in outbound cash was declared to Afghan Customs Department personnel at the Kabul

International Airport during 2010, including about \$482 million (or 36 percent of the total) in U.S. dollars. As a result, the U.S. government has implemented programs to develop the Afghan government's capacity to regulate its financial sector and strengthen controls over U.S. funds that enter and leave Afghanistan.

- **USAID's Economic Growth and Governance Initiative (EGGI)**, a program active from August 2009 until it was terminated for convenience by USAID in April 2011, provided support to DAB to, among other things (1) strengthen its ability to conduct oversight of commercial banks through onsite and offsite audits (2) improve macroeconomic decision-making through data collection and analysis, and (3) promote the adoption of amendments to existing banking laws. Under this initiative, EGGI advisors mentor and support various departments in DAB, including the Financial Supervision Department (which regulates commercial banks, hawalas, and other financial institutions in Afghanistan) and the Office of General Counsel (which drafts commercial banking regulations and proposes financial sector laws on behalf of DAB to the Afghan Parliament).⁹
- **Treasury's Hawala Registration and Support for the Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA)**¹⁰ supports DAB in its efforts to register hawalas and prevent money laundering or the illicit use of U.S. funds. Under Afghan law, all operating hawalas are required to be licensed and report their transactions periodically to DAB. Treasury has also mentored DAB's anti-money laundering/countering the financing of terrorism (AML/CFT) staff to more effectively regulate AML/CFT programs being implemented at commercial banks and other financial institutions. In addition, Treasury has provided equipment and technical assistance to FinTRACA to increase its capacity to monitor currency flows throughout Afghanistan.
- **DOD's Task Force for Business and Stability Operations (TFBSO)** has initiatives to increase Afghan banks' ability to accept EFT transactions and to develop a retail payments infrastructure that will allow banks to establish an Automatic Teller Machine/Point of Sale (ATM/POS) network.¹¹ In March of 2010, TFBSO established an EFT Assistance Center, which receives calls from banks, contractors, and U.S. agency contracting offices to address problems they may have when making EFT payments.
- **DHS's Bulk Cash Flow Action Plan** is a program to help the Afghan government monitor the flow of currency leaving the Kabul International Airport—an important component of strengthening Afghanistan's financial sector. DHS officials have trained Afghan law enforcement officials in methods to identify bulk cash smuggling. DHS also established Operation FinTRAX, an initiative to place bulk currency counters at the Kabul International Airport to monitor the outflow of funds from Afghanistan. Additionally, U.S. and Afghan law enforcement personnel can use

⁹ USAID has provided assistance to build DAB's capacity under other initiatives since 2003.

¹⁰ FinTRACA is the financial intelligence unit of DAB and receives data on financial activity to identify financial crimes and assist law enforcement agencies in investigation and prosecution of criminal activity. Typically, financial intelligence units are based within the central bank, the Ministry of Finance, or regulatory agency of a country and provide intelligence on suspicious transactions to law enforcement organizations for investigation and arrest.

¹¹ A POS transaction is a form of electronic payment developed for the retail sector in which consumers may use credit or debit cards to make payments to vendors. According to TFBSO officials, the funding for the development of the retail payments infrastructure project has been put on hold by State and negotiations among TFBSO, State, and Treasury are underway to continue the project or find alternatives.

these data to identify individuals suspected of bulk currency smuggling or other financial crimes.¹²

Table 1 shows the funds that USAID, Treasury, DOD, and DHS have obligated and expended under these initiatives.

Table 1: U.S. Obligations and Expenditures for Programs to Improve Afghan Financial Sector Regulation, as of December 2010

Department or Agency	Program	Obligations (dollars in millions)	Expenditures (dollars in millions)
USAID	Economic Growth and Governance Initiative	\$8.9	\$5.9
Treasury	Hawala registration and support to FinTRACA	\$6	\$2.7
DOD	TFBSO banking sector development initiative	\$4	\$2
DHS	Bulk Cash Flow Action Plan implementation	\$1.8	\$1.2
Total		\$20.7	\$11.8

Source: SIGAR Analysis of USAID, Treasury, DOD, and DHS data.

Note: Obligations for the EGGI program were derived from contractor estimates.

Additionally, the Afghan Threat Finance Cell (ATFC), an interagency fusion center established in 2009, uses diplomacy, law enforcement actions, military operations, and targeted financial measures to address threat finance in Afghanistan. The Drug Enforcement Administration heads the ATFC, with representatives from Treasury and DOD. ATFC operations are focused on addressing corruption within the Afghan government, disrupting insurgency financing, and attacking the Afghan narcotics trade. According to ATFC officials, the ATFC works with two Afghan counterparts, FinTRACA and a vetted police unit called the Sensitive Investigative Unit's Financial Investigative Team.¹³

LIMITED INTERAGENCY COORDINATION AND INCONSISTENT AFGHAN COOPERATION HAMPER EFFECTIVENESS OF PROGRAMS TO STRENGTHEN THE AFGHAN FINANCIAL SECTOR

Although U.S. agencies reported some progress in strengthening the Afghan government's ability to regulate its financial sector, two challenges are preventing U.S. programs from fully achieving their intended results. First, U.S. agencies have not fully coordinated their development efforts. Although several U.S. strategic documents concerning operations in Afghanistan emphasize the importance of interagency coordination in Afghanistan, we found instances in which U.S. agencies were not fully

¹² Because the Bulk Cash Flow Action Plan and Operation FinTRAX are designed both to strengthen the Afghan financial sector and to bolster visibility over U.S. funds flowing through the Afghan economy, we discuss findings related to these initiatives in both sections of this report.

¹³ According to DHS Officials, the Afghan Sensitive Investigative Unit is a cadre of Afghan National Police investigators who have been trained and mentored by DHS and other U.S. agency advisors.

collaborating with one another. For example, DOD and DHS officials have not coordinated their efforts involving their work with the same banks. As a result of limited interagency coordination, these agencies are at a risk of working at cross purposes, or, at a minimum, missing opportunities to leverage existing relationships and programs. Second, limited cooperation from Afghan ministries has delayed the implementation of U.S. programs or is preventing them from achieving their intended results. For instance, USAID officials reported that DAB has resisted efforts to conduct an onsite examination of Afghan commercial banks because DAB officials believe that such supervision would be too difficult to implement. Additionally, officials from the U.S. Embassy in Kabul reported that as of May 2011, Treasury no longer provides technical advisors at DAB and described the working conditions at DAB as “hostile.” Limited cooperation from the Afghan ministries may reduce the effectiveness of U.S. financial sector development efforts.

U.S. Agencies Have Not Fully Coordinated Their Programs to Develop Afghanistan’s Financial Sector

Interagency coordination has improved in the wake of the Kabul Bank crisis; however, we found that U.S. agencies have not fully coordinated their financial sector development programs. Several U.S. strategic documents for Afghanistan emphasize the importance of interagency coordination. For instance, according to the Afghanistan/Pakistan Regional Stabilization Strategy,¹⁴ U.S. civilian and military agencies are to combine their efforts to achieve their objectives in Afghanistan. Additionally, the *U.S. Government Integrated Civilian-Military Campaign Plan for Support to Afghanistan*¹⁵ states that the implementation of U.S. reconstruction initiatives in Afghanistan depends on effective integration of civilian and military resources. Finally, the U.S. Government Accountability Office (GAO) has identified key practices that can help enhance and sustain interagency coordination.¹⁶ These practices include establishing communication tools to operate across agency boundaries, including all stakeholders in developing mutually reinforcing or joint strategies, leveraging resources by defining and addressing problems, and agreeing on agency roles and responsibilities.

Prior to the run on Kabul Bank, officials from USAID, Treasury, and DOD did not regularly meet to discuss their efforts to develop the Afghan financial sector. In September 2010, USAID and Treasury created the Financial Sector Working Group to coordinate their response to the Kabul Bank crisis and share information on relevant development programs. The Financial Sector Working Group was created to increase the volume of information that U.S. agencies and international organizations, such as the International Monetary Fund (IMF), receive from DAB and other Afghan ministries regarding the health of Kabul Bank. According to USAID and Treasury officials, while the working group was created in response to the Kabul Bank crisis, they intend to continue meeting after the crisis is resolved to continue coordinating U.S. agency financial sector development efforts. In addition to Treasury and USAID officials, the working group includes representatives from DOD’s TFBSO and Deloitte contractors that performed work for USAID under the EGGI contract. Representatives from the World Bank and the International Monetary Fund also attend. In weekly meetings, working group members provide updates on their agencies’ financial sector development efforts and identify areas where members can reduce duplication of effort. Additionally, members discuss systemic risks to the financial sector in Afghanistan. Previous topics have included the health of banks that DOD uses to make EFT payments to contractors, negotiations between DAB and the International Monetary Fund over DAB’s response to the Kabul Bank

¹⁴ Office of the Special Representative for Afghanistan and Pakistan: *Afghanistan and Pakistan Regional Stabilization Strategy* (Washington, D.C.: February, 2010).

¹⁵ U.S. Embassy in Kabul/U.S. Forces-Afghanistan: *United States Government Integrated Civilian-Military Campaign Plan for Support to Afghanistan* (Kabul, Afghanistan: February, 2011).

¹⁶ GAO-06-15, *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies* (Washington, D.C.: October 21, 2005).

crisis, and the effects of the Kabul Bank crisis on U.S. operations in Afghanistan. The working group has also coordinated efforts to finance the forensic audit of Kabul Bank and other Afghan banks. We observed a working group meeting and found that members engaged in a frank and open discussion of financial sector issues and shared important updates on financial sector development program initiatives. U.S. agencies also participate in other working groups to discuss financial sector and counter threat finance issues, including the U.S. Embassy's Executive Level Working Group and the Illicit Finance Working Group.

Nevertheless, we found instances where agencies were not achieving the level of coordination needed to realize U.S. reconstruction objectives for Afghanistan. For instance, we found that the Financial Sector Working Group did not include all agencies involved in implementing financial sector development programs. Specifically, DHS, which is implementing programs to strengthen the visibility over currency flows through the financial sector, was not a member of the working group. As a result, DHS may have been unaware of other agencies' efforts, and members of the Financial Sector Working Group may not know of DHS's efforts. For instance, some DHS officials we spoke with were unaware of DOD's role in renovating FinTRACA's headquarters.¹⁷ The renovation has caused a delay in connecting the bulk currency counters that DHS is installing at the Kabul International Airport to FinTRACA and ATFC. DHS and FinTRACA officials agreed to postpone the installation of the server at their office until FinTRACA has relocated to its new location. (DHS did not want to incur the cost of installing the servers, which would connect the counters to FinTRACA and ATFC through the internet, at both FinTRACA's old and new locations). Had DHS been a member of the Financial Sector Working Group, the two agencies could have coordinated more closely to avoid the delay or, at a minimum, ensured that DHS was fully informed as to the reason for the delay.

Furthermore, U.S. agencies involved in financial sector initiatives have not always developed mutually reinforcing or joint strategies to guide their efforts. For instance, TFBSO provides assistance to Afghan commercial banks to develop their EFT processing capabilities through a commercial bank consortium that provides a platform whereby Afghan commercial banks can develop a retail electronic payments infrastructure. TFBSO has also facilitated the partnership signed between Citibank and AIB. The agreement established AIB as the primary Afghan commercial bank for DOD vendor payments. DHS has also been working directly with AIB to install bulk currency counters at the bank through Operation FinTRAX. However, TFBSO officials told us they were unaware of DHS' efforts. As a result, these agencies may be missing opportunities to leverage their efforts and implement their projects more efficiently and effectively.

Inconsistent Afghan Cooperation Has Negatively Impacted Programs to Strengthen Afghanistan's Financial Sector from Achieving Their Intended Results

Although USAID, Treasury, and DHS have reported progress in strengthening the Afghan financial sector, we identified instances in which limited Afghan cooperation has hindered these programs. For example, USAID officials reported that some Afghan ministries have resisted efforts to strengthen oversight over Afghanistan's banking system. Additionally, the Afghan government has appeared reluctant to prosecute cases despite Treasury's efforts to help DAB identify and respond to financial crimes. Furthermore, the Afghan government has banned U.S. government advisors from working at DAB. Finally, Afghan officials have resisted instituting certain controls over cash leaving Kabul International Airport, thereby threatening the success of DHS's Bulk Cash Flow Action Plan.

¹⁷Funds used to support FinTRACA's move to its new facility were committed by ATFC, which used Drug Enforcement Administration obligations.

Lack of Sufficient Cooperation from Afghan Ministries Limits Effectiveness of USAID's EGGI Program

USAID has made some progress in its initiative to build DAB's capacity to regulate the financial sector, but inconsistent Afghan cooperation has limited the effectiveness of USAID's program. USAID initiated EGGI in 2009 through a contract with Deloitte, LLP.¹⁸ The EGGI program's goals included implementing a variety of economic development activities and capacity building efforts such as mentoring the staff of DAB's Financial Supervision Department on methods to regulate the financial sector.¹⁹ Additionally, EGGI's goals included providing assistance to DAB in strengthening macroeconomic policies and strengthening financial sector legal and regulatory reforms. USAID obligated about \$8.9 million²⁰ to provide advisors and technical equipment to support its training programs. With EGGI's support, the Financial Supervision Department's staff increased from 12 personnel, who had limited qualifications, to 60 personnel, who had been trained in methods to regulate banks. According to USAID officials, regulators from the Financial Supervision Department now conduct monthly and quarterly audits of commercial bank financial records. EGGI advisors also assisted DAB in reporting its solar year (SY) 1388 (March 2009-March 2010) financial statements on time for the first time since DAB's reestablishment in 2003.

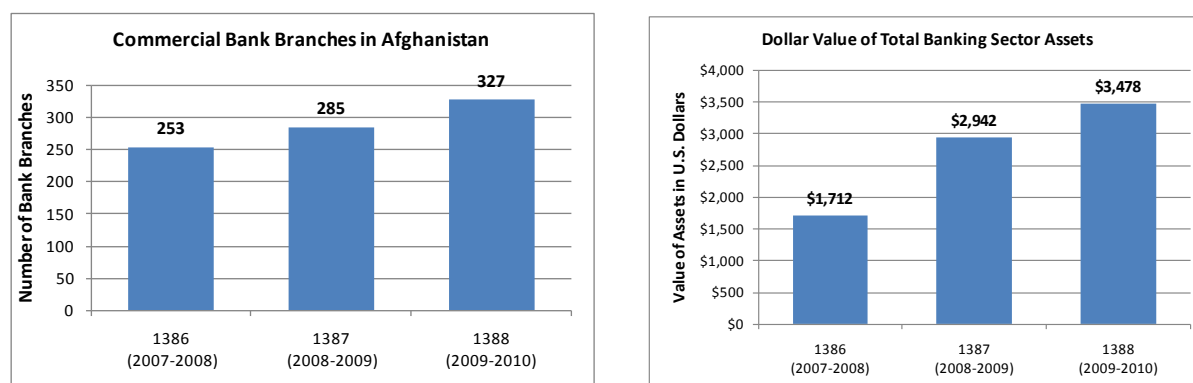
Other data indicate that EGGI has had some successes. For example, Deloitte showed progress in meeting a number of USAID-established performance indicators, such as the growth of the financial sector in Afghanistan. With EGGI's support, the number of commercial banks operating in Afghanistan (a key performance indicator) has increased from 6 state-owned banks that provided limited commercial banking services in 2003 to 17 commercial banks in 2010, 10 of which are Afghan-owned companies. The number of bank branches has also increased to 327 in SY 1388 (see Figure 2). Collectively, these banks reported managing more than \$3.4 billion in assets in SY 1388 (March 2009-March 2010). Furthermore, the number of Afghans with accounts at commercial banks (another key performance indicator) has also grown, from roughly 2 percent in SY 1386 (March 2007-March 2008) to more than 5 percent in SY 1388 (March 2009-March 2010).

¹⁸ Deloitte's responsibilities under the EGGI contract unrelated to developing DAB's capacity to regulate the financial sector include (1) providing support to the Ministry of Finance to improve economic forecasting; (2) assisting various Afghan ministries to strengthen private sector development; and (3) working with local governments to implement economic policy reforms. USAID originally awarded the contract (EEM-I-00-07-00005-00) to BearingPoint, which sold its public services businesses (including the EGGI contract) to Deloitte in May 2009. Because the same advisors who worked for BearingPoint continued to perform services under Deloitte, we refer to Deloitte as the contractor for the purposes of this report.

¹⁹ DAB's Financial Supervision Department's responsibilities include regulating Afghanistan's commercial banks and other financial institutions by conducting oversight over the financial statements of these organizations to reduce systemic failures in the financial sector.

²⁰ While the total cost of the EGGI contract was \$92 million, \$8.9 million was dedicated to financial sector development.

Figure 2: Number of Commercial Bank Branches and Dollar Value of Assets Managed by Afghan Banks (in millions)



Source: SIGAR Analysis of DAB data.

However, our review of EGGI also indicates that Deloitte did not meet all of the targets set by USAID. For example, EGGI contractor personnel produced only 2 of the 4 monetary policy briefs they were supposed to produce from October 2010 to March 2011. Additionally, several of EGGI's performance targets for conducting onsite and offsite reviews of commercial banks were not always met from October 2010 to March 2011. For instance, EGGI contractor personnel planned to assist DAB's Financial Supervision Department in conducting 41 onsite examinations of commercial bank financial records, but DAB completed only 22 from October 2010 through March 2011. Additionally, EGGI's targets included supporting the Financial Supervision Department's issuance of 27 enforcement actions against commercial banks to call for an improvement in commercial bank management, but the DAB only issued 16 such actions.

This uneven performance may be due, in part, to the difficulty that USAID experienced obtaining full cooperation from the Afghan government in implementing EGGI. We identified a number of instances in which this occurred. For example, EGGI's goals included supporting the passage of key banking sector reform legislation, such as strengthening risk assessment procedures at commercial banks and preventing commercial bank shareholders from serving as bank executives. However, EGGI contractor officials stated that, in some cases, the Afghan Parliament has been reluctant to pass laws, such as the adoption of leading banking regulation practices that conflict with the interests of Afghan commercial banks. Additionally, according to USAID, Afghan ministries have not developed long-term strategic plans that ensure sustainability of USAID-funded projects, despite pressure from USAID to do so. In some cases, USAID officials stated that DAB officials resisted programs that they believed to be difficult to implement, even though they represented best practices for central bank operations. For instance, as part of their support to the Financial Supervision Department, USAID officials proposed that DAB employees conduct detailed onsite examinations of commercial banks to ensure the soundness of the banking sector. However, according to USAID, senior DAB officials did not agree to onsite examination of commercial banks and instead proposed that the DAB employees being supervised by USAID mentors review records that commercial banks provide to DAB headquarters. Eventually, DAB officials agreed to support the establishment of onsite examinations by DAB's Financial Supervision Department. Finally, U.S. officials reported that weak cooperation from Afghan ministries delayed the forensic audit of Kabul Bank.²¹ Following media reports that raised concerns of widespread fraud at Kabul Bank, EGGI contractors advised DAB to conduct a forensic audit of Kabul Bank and other Afghan banks to explore the possibility of fraudulent loans made by Afghan commercial banks. DAB initially agreed to conduct a

²¹ A forensic audit includes reviews of payments to identify financial misconduct, abuse, or wasteful activity.

forensic review of Kabul Bank and asked for Treasury and the International Monetary Fund to finance it. However, the Afghan government withdrew the request in November 2010, after Treasury specified that to finance the audit, a number of conditions would have to be met. Under Treasury's conditions, independent auditors would conduct the forensic audit, Treasury could review the results of the audit, and the Afghan government would agree to implement any recommendations made in the audit. After continuing negotiations, the British and Canadian governments agreed to finance the forensic audit in January 2011. According to ATFC officials, DAB will be responsible for passing a copy of this audit to the IMF once it is completed.

In February 2011, USAID terminated the financial sector-strengthening component of the EGGI program and moved DAB activities to a 5-year project – the Financial Access for Investing in the Development of Afghanistan (FAIDA) – whose goals include strengthening the Afghan financial sector. In May 2011, USAID announced the launch of FAIDA, a \$74 million project that was awarded to Chemonics International. FAIDA's objectives include working with Afghan ministries, commercial lenders, and financial sector organizations to improve financial access in Afghanistan and developing the legal framework and market infrastructure to improve the Afghan economy.

Limited Number of Prosecutions by Afghan Government Hinders Treasury's Efforts to Address Money Laundering and Terrorist Financing

Treasury has had some success in its efforts to strengthen DAB's capability to address financial crimes, but the Afghan government has not always prosecuted these crimes. Treasury's initiatives include providing support to DAB's AML/CFT office in its efforts to license hawalas, training and mentoring AML/CFT personnel in conducting reviews of commercial banks' AML/CFT compliance programs, and assisting FinTRACA in improving its ability to identify persons suspected of financial crimes. Treasury has made some progress in these efforts, including assisting DAB to register almost 170 Kabul-based hawalas which have more than 650 branches in the provinces. Additionally, Treasury implemented a program to train DAB regulators in conducting AML/CFT reviews at commercial banks, which as of October 2010 had had overseen reviews of 15 of the 17 commercial banks operating in Afghanistan to assess their compliance with AML/CFT standards. FinTRACA's ability to identify money laundering has increased with Treasury's assistance. For instance, according to Treasury officials, FinTRACA information has been used to stop two money laundering networks operating at the Kabul International Airport, one of which recovered more than \$1.2 million in illicit funds. In another instance, FinTRACA worked with the ATFC and the Afghan Sensitive Investigative Unit to support an investigation into money laundering activities in connection with the Hajj.²²

However, the Afghan Attorney General's office has not cooperated fully in prosecuting individuals suspected of financial crimes, which has limited FinTRACA's effectiveness. According to DAB officials, FinTRACA has received more than 1.8 million Large Cash Transaction Reports, over 600 Suspicious Transaction Reports, and between 10,000 to 13,000 currency declaration reports from passengers leaving Afghanistan via Kabul International Airport.²³ FinTRACA officials reported that they forwarded 21 leads to Afghan law enforcement organizations, including the Ministry of Interior, the Major Crimes Task Force, and the Afghan Attorney General's office. However, according to these officials, the Attorney General's office pursued only 4 of the 21 leads to prosecution. Treasury officials indicated that

²² The Hajj is a religious pilgrimage that Muslims take to Mecca, Saudi Arabia.

²³ Large Cash Transaction Reports and Suspicious Transaction Reports are two types of reports that financial institutions file with FinTRACA. Large Cash Transaction Reports are filed when customers conduct transactions of more than 1 million Afghanis (about \$22,000). Suspicious Transaction Reports are filed when customers engage in unusual or suspicious transactions that could be related to illicit or terrorist activity.

they were not satisfied with the level of prosecutions and were concerned that some cases were dropped without a full explanation.

In May 2011, Treasury officials informed us that Afghan President Hamid Karzai had postponed allowing Treasury advisors to work at DAB while negotiations related to the International Monetary Fund's aid to Afghanistan were underway. Subsequently, he decided that U.S. government advisors were no longer welcome at DAB. According to U.S. Embassy officials, they have no plans to re-engage with DAB. Furthermore, Treasury officials described the working conditions at DAB as "hostile."

Limited Afghan Cooperation Hinders DHS's Efforts to Strengthen Controls over Currency Flows at Kabul International Airport

DHS has made some progress in implementing its Bulk Cash Flow Action Plan to strengthen visibility over currency flows through the Afghan economy, but limited Afghan cooperation has prevented DHS from achieving its intended results. In November 2009 and February 2010, DHS officials conducted two operations to identify the inbound and outbound flow of currency in the passenger declaration and inspection process at Kabul International Airport. As a result of concerns about the lack of controls over the significant flow of currency through the airport, DHS developed the Bulk Cash Flow Action Plan with assistance from Afghan ministries that conduct operations at the airport. DHS's responsibilities under the Bulk Cash Flow Action Plan include supporting the Afghan government to improve airport operations to strengthen controls over passengers entering and leaving the airport with illicit items (including bulk cash), and conducting a series of training sessions for Afghan law enforcement officials. DHS has successfully implemented a number of changes to airport operations, including establishing a secured customs area where passengers can declare bulk currency, introducing the use of a serialized customs form to record passenger cash declarations, and posting signs informing outbound passengers of the requirement to declare their currency to Afghan customs personnel.²⁴

DHS has also implemented programs to train Afghan border and customs personnel. For instance, DHS spent about \$100,000 to conduct four 1-week training sessions for 84 Afghan law enforcement, security, and customs officials on bulk cash smuggling. The training was held at the Major Crimes Task Force and at the Kabul International Airport. According to DHS officials, as a result of this training, Afghan Border Police personnel along with other Afghan officials interdicted approximately \$100,000 in counterfeit U.S. currency during passenger processing of an inbound international flight. Additionally, DHS officials reported that they worked with other donor nations and organizations to create the Afghan National Customs Academy, which trains Afghan customs personnel in methods to detect illicit movements of goods, people, and funds.

However, the Afghan government has not fully supported DHS efforts to institute additional controls at the airport. In July 2010, DHS awarded a contract to install two custom-built bulk currency counters for the airport customs areas, as well as in EFT-capable banks.²⁵ According to DHS officials, once the machines were delivered, the installation was delayed by seven months because U.S. and Afghan officials disagreed on where to install the counters. According to DHS officials, the machines were installed in early April 2011. At that time, Afghan customs officials were using the machines to count declared cash, but not to record serial numbers or report financial data to FinTRACA. According to DHS officials, many of the airport workers felt uncomfortable using the machines and needed time to gain

²⁴ Additionally, DHS has implemented other customs controls at the airport that are not directly related to the detection of bulk cash, such as sharing risk management techniques to enhance Afghan customs personnel's ability to detect smuggling, conducting an inventory of all x-ray scanners used at border crossings, and improving security in the airport's cargo areas.

²⁵ The contract, worth about \$117,000, was awarded to the Intelligent Currency & Validation Network.

familiarity with the machines' basic function of counting cash. DHS hopes to begin using the machines to record serial numbers once FinTRACA moves into its new facility.²⁶

DHS efforts to strengthen controls at the airport have been hampered in other ways. For example, passengers designated by the Afghan government as VIPs bypass the main security and customs screenings used by all other passengers and instead use a separate facility to enter the secured area of the airport. While VIPs are required to declare their currency, Afghan officials reportedly have no plans to scan their cash through electronic currency counters. Although the Afghan Customs Department drafted a proposal to subject VIP passengers to the same screening as general passengers, Afghan Customs Department officials raised objections as to which Afghan ministry would be responsible for administering the proposal and asked DHS to mediate a solution. However, DHS officials stated that a solution could not be reached, and the proposal was ultimately withdrawn. DHS officials reported that they are not allowed to visit the VIP facility to observe how passengers are screened and when we visited the airport, we were also not permitted to access the VIP area. Furthermore, ATFC officials informed us that, although a new VIP area was constructed to ensure better oversight, VIPs are continuing to use the old facility.

Finally, while DHS successfully worked with Afghan officials to install signs at the airport informing passengers of the requirement to declare cash totaling one million Afghanis or more than (roughly \$22,000 or equivalent in other currencies) prior to leaving Afghanistan through the airport, DHS officials told us that it took 8 months for Afghan officials to agree on where to place the signs and what exactly they should say. DHS officials also noted that they were unable to get approval to place the signs at the entrance to the airport, before passengers pass through customs. As a result, passengers are not informed of the requirement to declare their currency until it is too late. According to DHS officials, Afghan airport officials told them that the signs could not be placed at the airport entrance because that space is reserved for advertisements.

LACK OF VISIBILITY OVER U.S. CASH ENTERING THE AFGHAN ECONOMY LEAVES THESE FUNDS VULNERABLE TO FRAUD OR DIVERSION TO INSURGENTS

U.S. agencies have taken steps to strengthen their oversight of U.S. funds, but the United States still has limited visibility over how these funds flow through the Afghan economy, leaving these funds vulnerable to fraud or diversion to insurgents. U.S. strategies for Afghanistan reconstruction require that U.S. agencies improve contracting and other payment practices to prevent the use of U.S. funds for illicit purposes. U.S. agencies have increased their reliance on electronic payments, strengthened some controls over funds at Kabul International Airport, and started developing infrastructure to make payments through mobile phones. However, we identified three vulnerabilities that could allow U.S. funds to be diverted for improper uses. First, U.S. agencies do not record the serial numbers of cash disbursed to contractors and other recipients of U.S. funds. Second, commercial banks do not record the serial numbers of EFT payments made by U.S. agencies to contractors and other recipients when they are monetized. Third, U.S. contracting regulations neither prohibit prime contractors from using unlicensed hawalas to pay subcontractors nor require prime contractors to use EFT-capable banks to make payments. Therefore, the United States is unable to record information on these funds when they enter Afghanistan's economy and the Afghan and U.S. governments are unable to track them as they move from person to person. This information would be useful for law enforcement purposes.

²⁶ As stated earlier in this report, DOD is helping to renovate FinTRACA's facility, and FinTRACA and DHS officials have agreed to postpone installing an internet connection at the airport until FinTRACA has moved to the new facility.

U.S. Strategies Require That Agencies Strengthen Oversight over Funds Disbursed into the Afghan Economy

Several U.S. reconstruction strategies require that U.S. agencies strengthen their oversight over the funds provided to contractors and other entities. For instance, the *Integrated Financial Operations Commander's Handbook*²⁷ states that DOD should improve its visibility over the recipients of U.S. funds and more effectively track funds as they move from person to person. Specifically, contracting agencies are to collect and share data on the recipients of U.S. contracts with U.S. and Afghan law enforcement and military personnel. Moreover, U.S. agencies are supposed to improve the quality of their existing data on the flow of funds through the Afghan economy to more effectively ensure that these funds are not being used for illicit purposes. Additionally, USAID acquisition regulations require that USAID agreement officers obtain certifications from non-governmental organizations that the organization does not support terrorism.²⁸ Furthermore, according to this policy, recipients of USAID awards are to take reasonable assurances that USAID's funds are not used to provide material support or resources to individuals or entities that engage in terrorist activity. U.S. agencies are also to improve their contracting activities by (1) ensuring that contracted funds are not used to empower insurgents; (2) improving visibility over the use of subcontractors; and (3) integrating contracting activity into intelligence, plans, and operations. According to the *Civilian-Military Campaign Plan for Support to Afghanistan*, U.S. agencies and the Afghan government are to improve identification of and action against criminal patronage networks and improve contracting to reduce the leakage of U.S. funds to the illicit market. To achieve these objectives, U.S. agencies are to make payments electronically where possible. For instance, DOD's Financial Management Handbook encourages DOD to make payments electronically where possible and to pay in local currency when using cash.²⁹ Additionally, a July 2010 USFOR-A policy states that DOD should make payments electronically to the maximum extent possible.³⁰

U.S. Agencies Have Taken Steps to Improve Oversight over Funds Entering the Afghan Economy

U.S. agencies have taken steps to strengthen their oversight over funds that enter the Afghan economy. Most significantly, the U.S. government has reduced the amount of payments made in cash by relying on electronic payments made through EFTs and mobile phones. According to State and TFBSO officials, EFT payments allow enhanced oversight, for instance by providing increased opportunities to detect overpayments. DOD's TFBSO reported that, as of March 2011, the task force had successfully recovered more than \$7 million in EFT overpayments that U.S. agencies made to contractors in Afghanistan. Had these payments been made in cash, it is possible that recovering these funds would have been more difficult, if not impossible.

We found that the U.S. Army's use of cash to pay contractors has decreased from about 8.7 percent (almost \$21 million) of total U.S. Army payments made to contractors in Afghanistan in January 2010 to 5.9 percent (about \$19 million) in January 2011. Total U.S. Army payments during this period were

²⁷ U.S. Joint Forces Command: *Integrated Financial Operations Commander's Handbook: A Joint Force Guide to Financial Operations* (Joint Warfighting Center, Suffolk, Virginia: November 2, 2010).

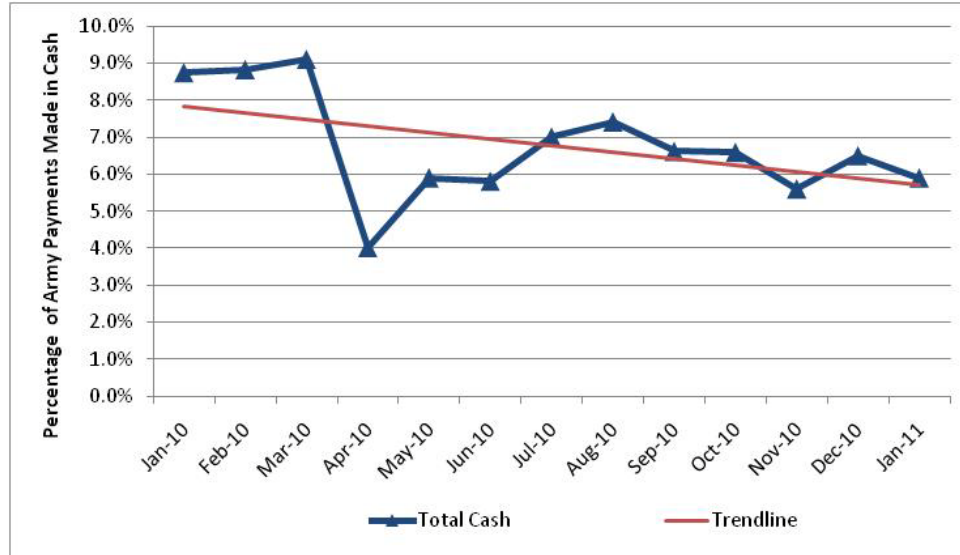
²⁸ USAID Acquisition & Assistance Policy Directive: Certification Regarding Terrorist Financing Implementing E.O. 13224 (AAPD-04-14): September 24, 2004.

²⁹ U.S. Army Field Manual No. 1-06 (supersedes FM 14-100). *Financial Management Operations*. Washington, D.C.: September 2006.

³⁰ U.S. Forces-Afghanistan Fragmentary Order 10-208. *Implements E-Commerce and Reduction of Cash in the Combined Joint Operational Area-Afghanistan*. July 2010.

about \$3.5 billion, and cash payments were almost \$235 million.³¹ Figure 3 depicts the percentage of payments made in cash by the U.S. Army Finance Office in Afghanistan.

Figure 3: Percentage of U.S. Army Finance Offices' Payments Made in Cash in Afghanistan



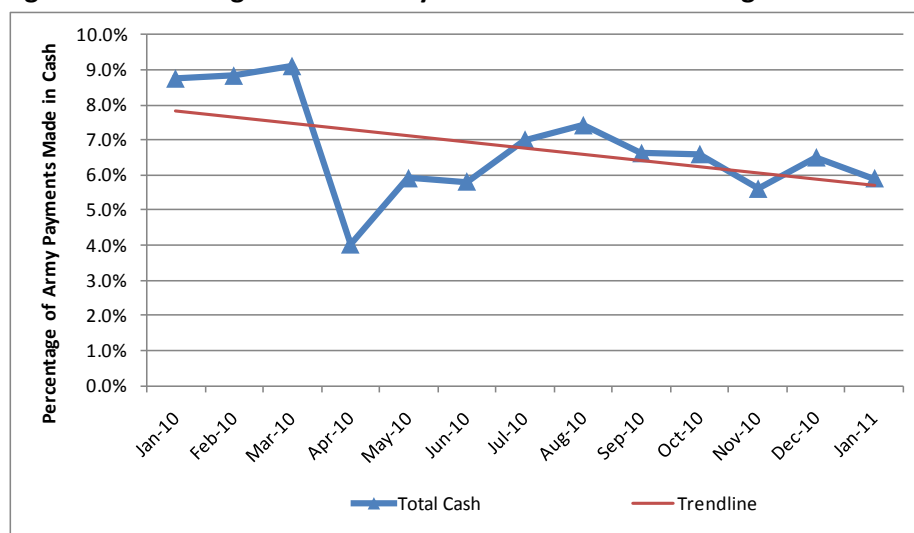
Source: SIGAR analysis of Defense Finance and Accounting Service data.

Note: Data include cash payments made in U.S. dollars and dollar value of cash payments made in Afghanis. Includes data on payments made to support DOD's military mission in Afghanistan, as well as payments made to implement Afghan reconstruction projects.

State's use of cash payments has also decreased, and most of State's payments – over \$185 million (or more than 98 percent) – were made through EFTs from January 2010 through March 2011. Cash payments made by State ranged from less than one percent to nearly three percent of its total payments (see figure 4).

³¹ This figure includes payments made to implement reconstruction projects in Afghanistan, as well as to support the U.S. military mission in Afghanistan. It does not include salary and benefits payments made to DOD employees or aid provided to support the salaries of Afghan National Security Forces personnel.

Figure 4: Percentage of State's Payments Made in Cash in Afghanistan



Source: SIGAR analysis of State's Office of Acquisitions Quality Management data.

Note: Data include cash payments made in U.S. dollars and dollar value of cash payments made in other currencies, including Afghanis. Includes data on payments made to support State's civilian in Afghanistan, as well as payments made to implement Afghan reconstruction projects.

USAID has also taken a number of steps to increase controls over its funds entering the Afghan economy. For instance, USAID officials reported that they use only EFTs to make payments to contractors, implementing partners, and other recipients in Afghanistan. From October 2009 through October 2010, USAID reported more than \$1.2 billion in payments made against contracts, grants, or cooperative agreements in Afghanistan. USAID is also supporting the development of the capability to transfer funds, repay project loans, and distribute employee salaries through mobile phones as part of the FAIDA program.³² This program builds on a DOD pilot program to support the salaries of Afghan National Police personnel to include other Afghan government employees by making payments electronically. Finally, in April 2011, a USAID-led task force, which included the ATFC, reiterated previous reports that found that U.S. funds may have been redirected to the Taliban or other insurgent groups. The task force made a number of recommendations to improve controls over funds in the areas of award mechanisms, partner vetting, financial controls, and project oversight.

In addition to decreasing cash payments, the U.S. government has taken steps to strengthen controls over cash leaving Kabul International Airport, as previously discussed in this report. Specifically, while DHS's Bulk Cash Flow Action Plan and Operation FinTRAX are designed to help build the Afghan government's capacity to monitor currency flows, they are also intended to help the U.S. government gain visibility over its funds.

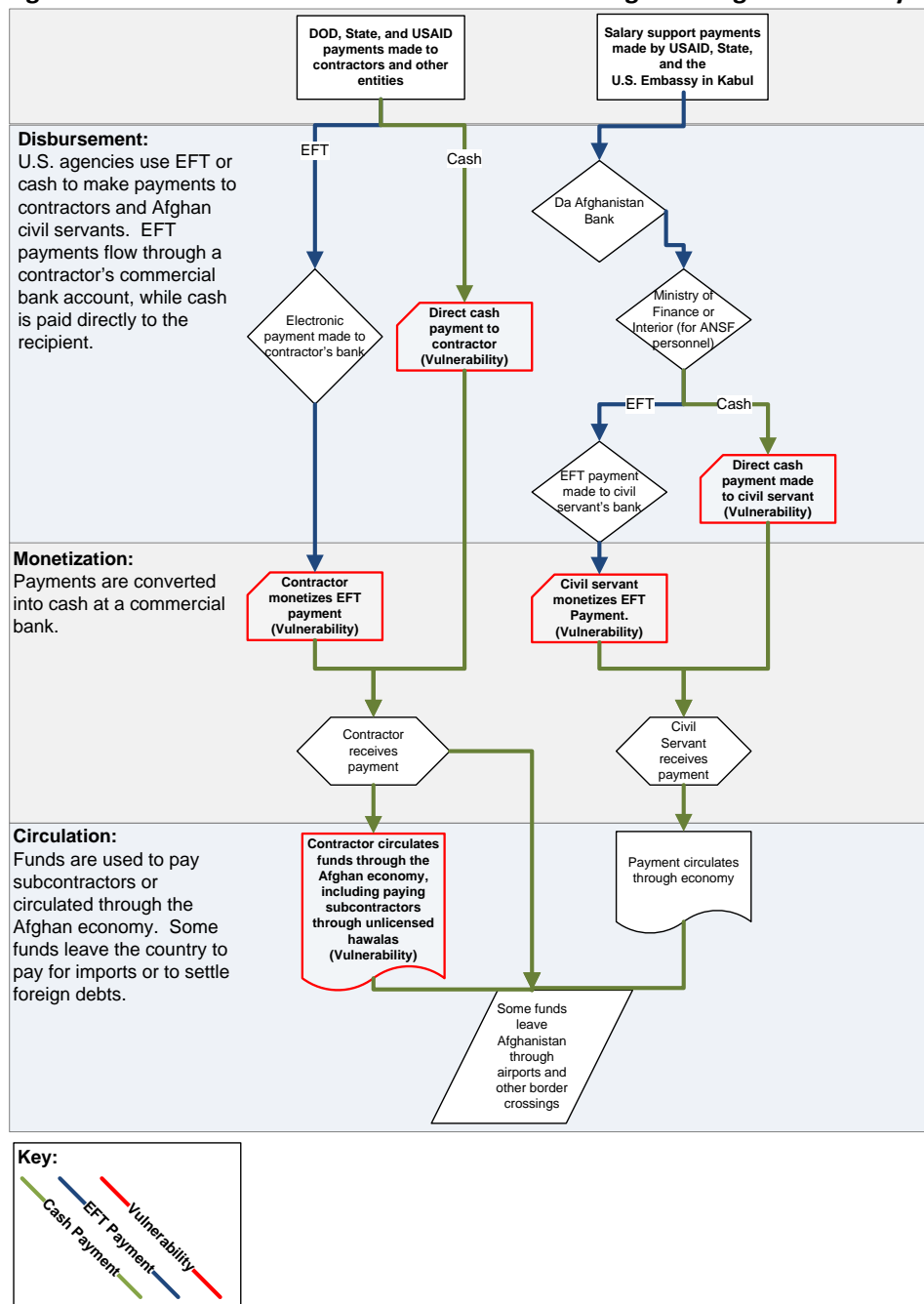
U.S. Reconstruction Funds Are Vulnerable Due to Insufficient Controls over U.S. Cash in the Afghan Economy

The United States has taken some steps to strengthen oversight over funds entering the Afghan economy; however, we identified three weaknesses that potentially leave these funds vulnerable to fraud or diversion to insurgents. First, DOD and State both stated that they do not record the serial

³² To make mobile phone payments, users first open a mobile money account via an agent, who has a formal bank account linked to a commercial bank. The user can use his or her mobile phone to send or receive money to other users electronically. The recipient of funds may transfer electronic funds to other users or monetize the funds through an agent.

numbers of cash payments made to contractors when these funds are disbursed. Second, commercial banks lack the capacity to record the serial numbers of EFT payments made to contractors and other recipients of U.S. funds when they are monetized. Third, U.S. contracting regulations neither prohibit prime contractors from using unlicensed hawalas to pay subcontractors nor require the use of EFTs to make payments. Figure 5 shows where these weaknesses occur as U.S. funds flow through the Afghan economy.

Figure 5: Vulnerabilities in Flow of U.S. Funds Through the Afghan Economy



Source: SIGAR analysis of information provided by State, Treasury, DOD, and DHS.

Note: Figure shows payments made through Afghan banks. U.S. agencies, such as DOD, also make payments through U.S. banks, but these payments do not directly enter the Afghan economy and are, therefore, not depicted in this figure. As we noted previously, USAID does not make cash payments to recipients.

U.S. Army and State Do Not Record Serial Numbers of Cash Payments

U.S. Army and State's visibility over the flow of cash payments through the Afghan economy is limited because DOD and State officials responsible for making these payments do not record the serial numbers of the cash before it is disbursed. Although not specifically required, recording serial numbers would allow U.S. and Afghan law enforcement personnel to track the movement of these funds once they are paid to contractors and other recipients. According to DHS officials responsible for implementing Operation FinTRAX, data on the serial numbers of cash paid by U.S. agencies could be used to prevent financial crimes. For instance, U.S. law enforcement personnel could scan the serial numbers of cash recovered from military operations to trace the source of these funds and determine the extent to which they passed through U.S. contractors. Additionally, U.S. and Afghan officials could use these data to identify U.S. funds that exit the country through Kabul International Airport by matching the serial numbers of currency paid to U.S. contracting agencies with data recorded by bulk currency counters at the airport. Without recording the serial numbers of cash prior to disbursement, U.S. agencies, such as the ATFC, miss an opportunity to gain greater visibility over these funds.

Absence of Bulk Currency Counters at Afghan Commercial Banks Limits U.S. Visibility over EFT Payments When They Are Monetized

U.S. agencies also lack visibility over EFT payments once they are monetized by contractors because Afghan commercial banks do not record the serial numbers of monetized payments. As we note above, the majority of the U.S. Army and State's payments to contractors are made electronically, and USAID reported that it only uses EFTs to make all its payments to contractors and implementing partners in Afghanistan. However, because Afghanistan's economy is cash-based, contractors that receive EFT payments typically monetize the deposits at commercial banks. This process reduces the oversight over the flow of funds because banks do not record the serial numbers of cash disbursed. Without this information, U.S. and Afghan law enforcement efforts to track the movement of U.S. funds from person to person are made more difficult.

To improve oversight over the flow of U.S. funds once they are monetized, DHS developed plans to place bulk currency counters at several Afghan commercial banks that manage payments made to recipients from U.S. sources. However, DHS officials have been unable to reach agreement with the banks as to how many counters would be purchased and where they would be installed. For example, one commercial bank wants DHS to install 19 bulk currency counters (one for its headquarters in Kabul and 18 for its branch locations throughout Afghanistan), but DHS is prepared to install only one machine at its headquarters. Installing the bulk currency counters at commercial banks and recording the serial number data on the EFT payments monetized by contractors would enhance the capacity of U.S. agencies to (1) monitor the flow of these funds through the Afghan economy and (2) more effectively identify persons suspected of using these funds for illicit purposes. According to DHS officials, they have approached USAID for assistance on this issue, but no final agreements have been reached. However, USAID officials reported to us that current USAID staff has no knowledge of this request for assistance.

U.S. Contracting Regulations Do Not Place Conditions on How Prime Contractors Pay Subcontractors

Although U.S. contracting regulations generally emphasize the use of electronic payments to make payments to prime contractors, no such regulations exist for prime contractors' payments to subcontractors. We reviewed DOD, State, and USAID contracting regulations, including the Federal Acquisition Regulation, and found that they do not require that contractors receiving U.S. funds pay subcontractors through either EFT-capable banks or licensed hawalas, which are required to submit their financial records to FinTRACA. Contracting officials at DOD's Defense Finance and Accounting

Service, State's Acquisition and Assistance Office, and USAID's Office of Financial Management staff confirmed that no such regulations exist. In June 2011, we discussed these issues with DOD officials responsible for setting contracting and financial execution policy. These officials stated that requiring the use of electronic payments by prime contractors to pay subcontractors may be difficult to enforce and could potentially conflict with some contracting regulations, including principles related to privity of contract.³³ However, other policies require contracting organizations to exercise enhanced oversight over subcontractors. For instance, according to USFOR-A contracting policy issued in September 2010, contracting organizations are to identify the use of subcontractors in Afghanistan and ensure that prime contractors are held responsible for subcontractor performance. Furthermore, according to this policy, prime contractors are responsible for providing detailed information on subcontractors.

We found that some prime contractors use hawalas, including those who are unlicensed, to transfer funds to subcontractors. For example, we previously reported about a hawala dealer who was contracted to transfer \$2.8 million in National Solidarity Program funds to program officials in Paktika province.³⁴ However, the World Bank reported that once these funds passed through a local hawala, they never reached their destination. Through our subsequent analysis, we determined that while the contracted hawala dealer was on Treasury's list of registered providers, a second hawala dealer that was used to transfer funds was not. Despite investigations by National Solidarity Program personnel and interventions on the part of the Afghan Attorney General's office, this hawala continues to retain the majority of these funds and refuses to deliver them to the intended communities.³⁵ Because unlicensed hawalas do not report their transactions to FinTRACA, U.S. and Afghan law enforcement personnel seeking to trace the source of currency lose oversight over funds when they pass through unlicensed hawalas.

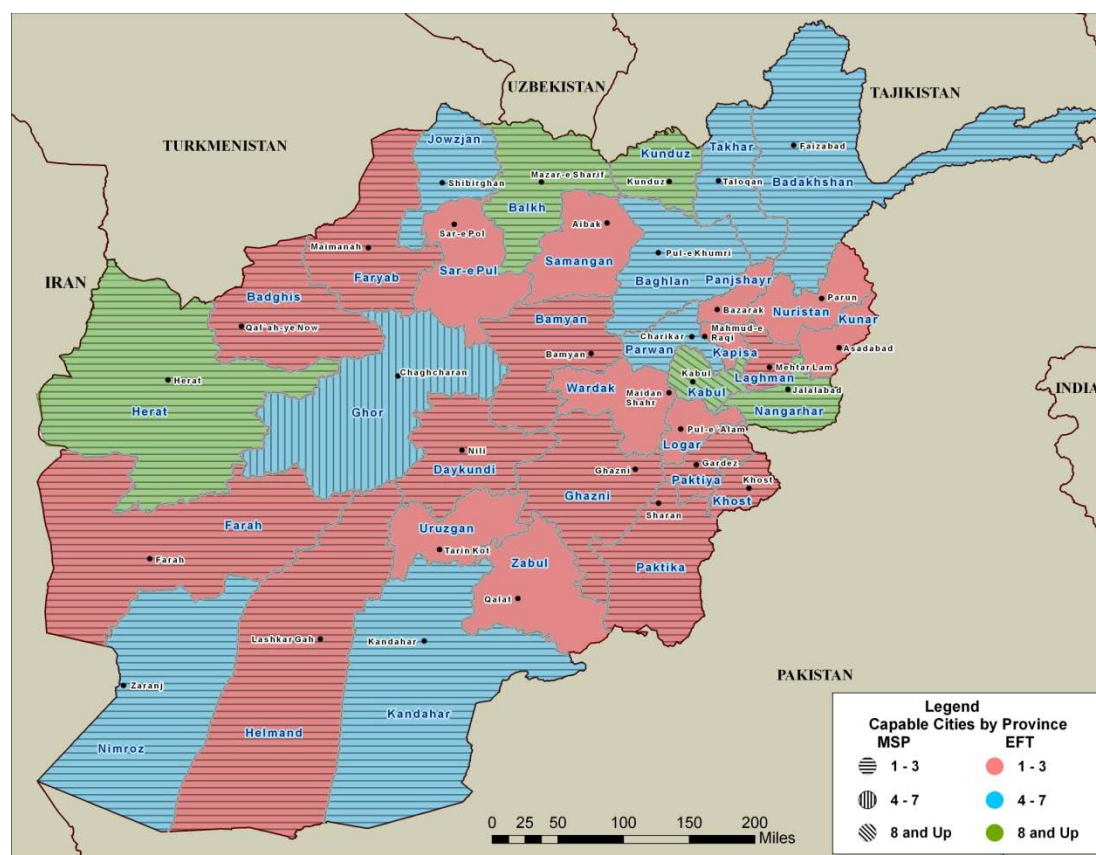
In February 2011, we discussed these issues with USAID officials and recommended that USAID ensure that prime contractors receiving USAID funds pay their subcontractors electronically whenever possible. Additionally, a task force created by USAID to enhance accountability of USAID funds recommended in April 2011 that USAID's implementing partners make electronic payments to subcontractors where the infrastructure exists. USAID Comptroller officials told us that, although they encourage their implementing partners to use EFTs to make payments to subcontractors, placing requirements on how payments are processed would "handcuff" their implementing partners, particularly those operating in remote areas of Afghanistan. We identified licensed hawalas in all but 9 provinces and EFT capable banks in all 34 provinces of Afghanistan. Furthermore, all Afghan provinces have at least one licensed hawala or EFT-capable bank (see figure 6).

³³ According to the Federal Acquisition Regulation, the U.S. government generally has no direct legal relationship with subcontractors that are employed by prime contractors unless such a relationship is specified by clause in the contract or required by agency contracting policy. See FAR Part 42.201.

³⁴ The National Solidarity Program (NSP) is a community development and local governance program managed by the Afghan Ministry of Rural Rehabilitation and Development. It is funded primarily through the Afghanistan Reconstruction Trust Fund, (ARTF) which is administered by the World Bank, and largely (almost 35 percent or \$528 million) funded by the United States. See SIGAR Audit 11-8. *Afghanistan's National Solidarity Program Has Reached Thousands of Afghan Communities, but Faces Challenges that Could Limit Outcomes* (Washington, D.C.: March 22, 2011).

³⁵ Due to the urgent nature of this incident, we informed the U.S. Ambassador to Afghanistan of this issue in December 2010 through a separate letter prior to completing our audit of the National Solidarity Program.

Figure 6: Map Indicating Locations of EFT Capable Banks and Licensed Hawalas in Afghanistan



Source: SIGAR analysis of Treasury data.

Note: Map provided by the U.S. National Geospatial Intelligence Agency. Boundaries and place names are not authoritative and should not be used for navigation or other related purposes.

CONCLUSION

Since 2002, Congress has appropriated more than \$70 billion to implement security and development assistance projects in Afghanistan, with some of those funds converted to cash and flowing through the Afghan economy. To ensure that the Afghan financial sector can absorb the influx of these funds and to develop the government of Afghanistan's capacity to sustain a viable market economy, U.S. agencies are implementing programs to increase DAB's capacity to regulate commercial banks and other financial organizations in Afghanistan. However, the near collapse of Kabul Bank in September 2010 and continued uncertainty about the health of Afghanistan's remaining banks demonstrate the challenges of developing effective regulatory capacity that limit systemic financial risks. Additionally, inconsistent Afghan cooperation on financial sector issues highlights the challenge of providing assistance in an environment where the effects of U.S. agency financial sector development efforts may be limited by the challenges in the Afghan judicial sector. While U.S. agencies have strengthened their coordination in the wake of the Kabul Bank crisis, more can be done to ensure that these initiatives are not duplicating efforts or, at a minimum, working at cross purposes. Furthermore, given the amount of U.S. cash that flows through the Afghan economy, it is imperative that the U.S. government have robust measures in place to ensure that these funds are not used for fraud or diverted to insurgent networks. However, we found that agencies have not instituted sufficient controls over U.S. funds, limiting their oversight over these funds and potentially the ability of the ATFC to ensure that these funds are not diverted to

insurgents. As a result, the U.S. risks inadvertently funding activities that directly oppose its reconstruction goals for Afghanistan.

RECOMMENDATIONS

We are making four recommendations to improve interagency coordination on financial sector development programs and to strengthen oversight over the flow of U.S. funds through the Afghan economy.

To help leverage available resources and expertise and avoid duplication of agency efforts on financial sector issues, the U.S. Ambassador to Afghanistan should instruct the members of the Financial Sector Working Group to:

1. Develop an interagency strategy to coordinate efforts to work with Afghan banks to increase their EFT, internal processes, and transaction accountability capabilities.

To strengthen oversight over the flow of U.S. funds through the Afghan economy and to support overall U.S. reconstruction goals in Afghanistan, the Secretary of State and the Secretary of Defense should instruct their contracting and financial authorities to:

2. Institute steps to record the serial numbers of cash disbursed to contractors and provide these data to U.S. law enforcement officials (including the Afghan Threat Finance Cell), as well as FinTRACA or another appropriate Afghan source.
3. Develop a plan to ensure that Afghan banks that provide payments to recipients of U.S. EFT payments record the serial numbers of cash paid to these recipients by using bulk currency counters and that these data are reported to U.S. law enforcement officials (including the Afghan Threat Finance Cell), as well as FinTRACA or another appropriate Afghan source.
4. Insert a standard clause into U.S. contracts, grants, and cooperative agreements with entities operating in Afghanistan requiring that these contractors pay their subcontractors through either an EFT-capable bank or a licensed hawala, where possible. Alternatively, if a determination is made that such a clause would not be feasible under existing regulations, submit a formal proposal to Congress with legislative language allowing the inclusion of such a clause.

COMMENTS

The U.S. Embassy in Kabul, DHS, and USAID provided written comments on a draft of this report. These comments are reproduced in appendices II-IV, respectively. We also provided DOD an opportunity to comment on a draft of this report, but they did not have any comments. Additionally, USAID, DHS, the Afghan Threat Finance Cell, and the U.S. Embassy in Kabul provided technical comments, which we incorporated as appropriate.

Our draft of this report included a recommendation that the members of the Financial Sector Working Group include DHS in their planning meetings. Because the U.S. Embassy Kabul, USAID, and DHS subsequently did so, we deleted the recommendation.

In its response, the U.S. Embassy in Kabul generally agreed with our recommendations, but cited some difficulties implementing them. For example, in response to our recommendation that U.S. agencies

develop an interagency strategy to coordinate efforts to work with Afghan banks to increase their EFT internal processes and transaction accountability capabilities, the U.S. Embassy noted that accomplishing this task will require consensus among and action by Afghan ministries, the U.S. government, and other donors implementing reconstruction and development projects in Afghanistan. The U.S. Embassy concurred with our last recommendation, stating that it will add a clause to its contracts requiring implementing partners make payments only through EFTs or licensed hawalas.

DHS commented that it was pleased to note the positive acknowledgment of its role in helping implement programs to develop the Afghan government's capacity to regulate its financial sector and strengthen controls over U.S. funds that enter and leave Afghanistan. It also stated that it remains committed to continuing its work with interagency partners, such as Treasury, and other relevant stakeholders in minimizing terrorist threats in Afghanistan, and in particular the threats posed by bulk cash smuggling.

In its response, USAID stated that, working through the Financial Sector Working Group, the U.S. Mission to Afghanistan agrees to seek consensus for, and commitment to contribute to, the development of a donor-supported, Afghan government-owned strategy to increase EFT processing capabilities and to install bulk currency counters at banks in Afghanistan. However, USAID expressed concern about our recommendation that the Secretary of State and Secretary of Defense instruct their contracting and financial authorities to insert a standard clause into awards requiring that implementing partners make payments through EFT or licensed hawalas. Although this recommendation is not directed to USAID, it noted that many of its implementing partners lack access to banks that provide EFT services. While the use of EFTs or licensed hawalas to make payments may not be practical in all circumstances, we determined that all Afghan provinces have at least one licensed hawala or EFT capable bank. In addition, our recommendation states that the proposed clause should stipulate that contractors pay their subcontractors through either an EFT-capable bank or a licensed hawala, where possible.

APPENDIX I: SCOPE AND METHODOLOGY

This report provides the results of the Office of the Special Inspector General for Afghanistan Reconstruction's review of U.S. assistance provided to develop the financial sector in Afghanistan and of U.S. controls over payments made to contractors and other entities in Afghanistan. The objectives of this audit were to (1) evaluate the U.S. efforts to improve the capacity of the Afghan government to regulate the financial sector and (2) to assess the controls that U.S. agencies use to track U.S. funds as they flow through the Afghan economy. Afghanistan's financial sector includes institutions such as commercial banks, hawalas, and the Afghan central bank (Da Afghanistan Bank, or DAB). We limited the scope of our second objective to a review of the controls implemented by the Departments of Defense (DOD) and State and the U.S. Agency for International Development (USAID) over payments made to contractors and other entities because these U.S. agencies have the greatest involvement in implementing reconstruction projects in Afghanistan.

To evaluate U.S. efforts to improve the capacity of the Afghan government to regulate its financial sector, we reviewed U.S. and Afghan strategies, plans, and other program documentation relevant to the financial sector development programs that U.S. agencies have implemented in Afghanistan.

- To evaluate the Department of Homeland Security's (DHS) financial sector development programs, we reviewed its Bulk Cash Flow Action Plan, an update to this plan, as well as a DHS briefing on financial sector issues. We reviewed contract data related to DHS's Operation FinTRAX, an initiative to place bulk currency scanners at the Kabul International Airport, and met with DHS officials in Washington, D.C. and Kabul, Afghanistan. Additionally, we conducted two site visits to the Kabul International Airport in February and April 2011.
- To evaluate Treasury's efforts to improve the capacity of the Afghan government to regulate its financial sector, we reviewed Treasury's agreements with the Afghan government outlining the roles and responsibilities of Treasury's advisors to be posted at DAB. We interviewed Treasury officials in Washington, D.C. and officials affiliated with the Treasury attaché office at the U.S. Embassy in Kabul. We also conducted a site visit to DAB in February 2011, where we also interviewed Afghan officials responsible for administering DAB programs.
- To evaluate USAID's efforts to improve the capacity of the Afghan government to regulate its financial sector, we reviewed Economic Governance and Growth Initiative (EGGI) contract documentation, including the contract and associated modifications issued against the contract, the contract work plan, and reports of performance provided by the contractor (Deloitte, LLP). SIGAR's forensic auditing team ran a series of tests on the EGGI contract to identify anomalies, which could indicate fraud, waste, or abuse, and we considered the results of those tests in our audit. We met with USAID officials responsible for administering the EGGI contract in Kabul and with Deloitte personnel responsible for performing work on the contract. Because key performance indicators established by USAID included increasing the number of commercial banks and use of the commercial banking system, we obtained data from DAB on the growth of commercial banks and the assets managed by commercial banks in Afghanistan.
- To evaluate the efforts of DOD's Task Force for Business and Stability Operations (TFBSO), we reviewed program documentation on its initiatives to develop the financial sector in Afghanistan. We met with a TFBSO official in Washington, D.C. to identify the program's efforts to improve the capacity of the Afghan financial sector. We also reviewed data provided by TFBSO on the contracts reviewed by the EFT Assistance Center.

In addition to our agency-specific assessments, we reviewed U.S. government efforts to strengthen coordination on financial sector issues. To accomplish this review, we analyzed U.S. strategies for reconstruction in Afghanistan and leading practice standards for interagency collaboration. We reviewed the minutes of the interagency Financial Sector Working Group and observed a meeting of this group. We also interviewed Financial Sector Working Group officials, including officials with Treasury and USAID, and met with World Bank officials who participate in working group meetings.

To assess the internal controls that U.S. agencies use to track U.S. funds as they flow through the Afghan economy, we reviewed relevant U.S. strategies, including the *Integrated Financial Operations Commander's Handbook*,³⁶ the *Civilian-Military Master Campaign Plan for Support to Afghanistan*,³⁷ and *DOD's Counterinsurgency Field Operations Manual*.³⁸ In addition, we reviewed a Fragmentary Order issued by U.S. Forces-Afghanistan³⁹ to strengthen oversight over U.S. funds and reduce the use of U.S. dollars in Afghanistan. We also identified the extent to which U.S. agencies make payments in Afghanistan in cash or electronic payments by collecting and analyzing data on disbursements made by DOD, State, and USAID from January 2010 through January 2011. DOD's Defense Finance and Accounting Service reported that it uses the Deployable Disbursing System Repository Initiative to manage this information. State's Office of Acquisitions Management previously reported that they use the Global Financial management system to record and store data on disbursements made in Afghanistan. USAID reported that it uses Phoenix Viewer to record and store data on disbursements made in Afghanistan.

To verify the reliability of computer-processed data provided by DFAS and USAID on payments made in Afghanistan by type (cash, EFT, or other media), we checked the data for missing or outlier values, confirmed individual and summary values with DFAS, USAID, and DHS officials, and traced a sample of summary-level records to their sources. Because we did not find any significant errors in these data, we determined that they were sufficiently reliable for the purposes of this report.

As part of our efforts to assess the controls that U.S. agencies have in place to track U.S. cash as it moves through the Afghan economy, we also interviewed program officials at State's Special Representative for Afghanistan and Pakistan, the DHS and Treasury attaché offices in Kabul, and DOD's Task Force on Business and Stability Operations. In addition, to identify the procedures used to record disbursements, we interviewed program officials with the Defense Finance and Accounting Service, the USAID Comptroller, and State's Office of Acquisitions and Assistance.

Finally, to obtain information on the use of hawalas in Afghanistan, we received data from Treasury on the names of licensed hawalas in English and in Dari. To verify that these data were accurate, we traced a sample of the English records to their equivalent Dari records and did not find significant differences in the records. We also used geolocation data provided by USAID to place the location of these hawalas throughout Afghanistan and plotted these data on maps provided by the National Geospatial Intelligence Agency.

³⁶ U.S. Joint Forces Command: *Integrated Financial Operations Commander's Handbook: A Joint Force Guide to Financial Operations* (Joint Warfighting Center, Suffolk, Virginia: November 2, 2010).

³⁷ U.S. Embassy in Kabul/U.S. Forces-Afghanistan: *United States Government Integrated Civilian-Military Campaign Plan for Support to Afghanistan* (Kabul, Afghanistan: February, 2011).

³⁸ U.S. Army Field Manual No. 3-24/U.S. Marine Corps Warfighting Publication No. 3-33.5. *Counterinsurgency* (Washington, D.C.: December 2006).

³⁹ U.S. Forces-Afghanistan Fragmentary Order 10-208. *Implements E-Commerce and Reduction of Cash in the Combined Joint Operational Area-Afghanistan*. July 10, 2010.

We conducted our work in Washington, D.C. and Kabul, Afghanistan, from October 2010 to July 2011 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was conducted by the Office of the Special Inspector General for Afghanistan Reconstruction under the authority of the Inspector General Reform Act of 2008, and Public Law No. 110-181, as amended.

APPENDIX II: COMMENTS FROM THE U.S. EMBASSY KABUL



Embassy of the United States of America
Kabul, Afghanistan

SENSITIVE BUT UNCLASSIFIED
DECISION MEMORANDUM

July 11, 2011

TO: Ambassador Karl W. Eikenberry *KW* 12 July 2011
THROUGH: Acting Deputy Ambassador David Pearce
FROM: CDDEA – Ambassador Richard G. Olson *RO*
SUBJECT: Response to SIGAR Audit 11-13, Afghan Financial Sector and Safeguarding U.S. Cash

CONTEXT

SIGAR requests Embassy response to draft Audit 11-13, "Limited Interagency Cooperation and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash." Tab 1, compiled with input from USAID, Treasury, and DHS, is our proposed response to SIGAR's recommendations.

RECOMMENDATION

That you approve the response to SIGAR at Tab 1.

Approve *KW* Disapprove _____ Let's discuss _____

3 Attachments:

Tab 1 – Draft Post Response to SIGAR Audit 11-13, Afghan Financial Sector and Safeguarding U.S. Cash

Tab 2 – SIGAR Audit 11-13

Tab 3 – USAID A3

Response to the Office of the Special Inspector General for Afghanistan Reconstruction's (SIGAR's) draft report 11-13 on: "Limited Interagency Cooperation and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash," to be issued July, 2011.

General comments on the SIGAR's Report on the Afghan Financial Sector.

The Embassy recommends that SIGAR modify the title of the audit to read, "Improved Interagency Cooperation and Additional Controls Over U.S. Funds Could Improve U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash."

The Embassy would like it to be stressed much more prominently in the report that Treasury no longer has technical advisors working in the Afghan Central Bank (DAB). Since December 2010, when the last advisor departed Afghanistan, Treasury has not had an advisor at FinTRACA. The advisor working in the Financial Supervision Department on anti-money laundering/countering the financing of terrorism (AML/CFT) departed in early March. Replacement advisors for both positions were to arrive in Kabul in March 2011 but those plans were postponed during the GIRoA-IMF negotiations in early 2011 and terminated after GIRoA President Karzai banned all USG advisors from DAB in May 2011. Treasury currently has no plans to re-engage at the Central Bank as the working conditions there for advisors have become hostile.

The Embassy also notes the challenge to and stresses on the Afghan Banking Sector without GIRoA first making more credible progress on the IMF prior actions for a new program designed to strengthen the banking sector in the aftermath of the Kabul Bank crisis. Furthermore, the recent arrests by the Attorney General, to include a number of DAB employees, has created more uncertainty at DAB in particular and regulation of the Afghan financial sector generally and may hamper efforts to assist Afghan banks in augmenting their EFT capability.

Embassy Responses to SIGAR Recommendations in Draft Report.

The SIGAR audit contains two official recommendations for Embassy Kabul:

To help leverage available resources and expertise and avoid duplication of agency efforts on financial sector issues, the U.S. Ambassador to Afghanistan should instruct the members of the Financial Sector Working Group to:

Recommendation # 1. Include DHS in their planning meetings and ensure that all U.S. agencies that support the development and strengthening of the Afghan financial sector be included in Financial Sector Working Group discussions.

Embassy response to Recommendation #1: As of June 5, 2011, international donors, implementing partners, and USG entities, including DHS, have been invited to participate in discussions of the Financial Sector Working Group.

Recommendation # 2. Develop an interagency strategy to coordinate efforts to work with Afghan banks to increase their EFT processing capabilities [REDACTED].

Embassy response to Recommendation #2: The Financial Sector Working Group coordinates the interagency effort with Afghan banks to increase EFT processing capabilities and improve internal processes and transaction accountability.

Accomplishing this task is not simply a unilateral USG interagency effort. Instead, it requires the consensus among and action by the Government of the Islamic Republic of Afghanistan (GIRoA) and other donors.

The Embassy's USAID encourages our implementing partners to use lawful, readily available and reliable methods to make payments under USAID-funded awards, including EFT, mobile banking, checks, and licensed hawalas. Many of our implementing partners, especially those who work in remote areas, do not have access to banks that require EFT services and there are no other alternatives, such as checks and mobile banking, to using licensed hawalas. Working through the Financial Sector Working Group, the U.S. Embassy Afghanistan agrees to add the requirement into our contract awards to require our implementing partners make payments only through EFT or licensed hawalas.

Additionally, USAID's Accountable Assistance for Afghanistan (A3) report (Tab 3), initiated last fall at the direction of Administrator Rajiv Shah, provides detailed research into how best to protect USAID development funds from being diverted from their intended use. The A3 recommends that our implementing partners "electronically transfer project funds to any subcontractors, when the financial infrastructure exists to do so." As an additional safeguard, the A3 also

recommends that the Embassy audit 100% of locally incurred cost on cost-reimbursement type acquisition and assistance awards. The Embassy has accepted this recommendation and has initiated steps to implement it.

It is also to be noted that the Office of the Inspector General/Afghanistan (OIG), in its Review Report No. F-306-11-002-S dated March 7, 2011 found that “the cash disbursement practices of the ten selected USAID/Afghanistan implementing partners reasonably ensured that their cash expenditures were reasonable, allocable, and allowable.” The OIG recommended that the Embassy disseminate to its implementing partners the best practices described in the report (including EFT or check payment to local vendors and subcontractors). The Embassy complied with the OIG recommendation through issuance of a letter on 2/17/2011 to its implementing partners. The Embassy’s implementing partners are therefore fully aware of the controls that are needed to ensure that USG funds are properly safeguarded.

APPENDIX III: COMMENTS FROM THE DEPARTMENT OF HOMELAND SECURITY

U.S. Department of Homeland Security
Washington, DC 20528



**Homeland
Security**

July 7, 2011

Mr. Albert H. Huntington, III
Acting Assistant Inspector General for Audits
Special Inspector General for Afghanistan Reconstruction
400 Army Navy Drive
Arlington, VA 22202

Re: Draft Report SIGAR Audit 11-13, "Limited Interagency Cooperation and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash"

Dear Mr. Huntington:

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) appreciates the Special Inspector General for Afghanistan Reconstruction's work in planning and conducting its review.

The Department is pleased to note the positive acknowledgment of its role in helping implement programs to develop the Afghan government's capacity to regulate its financial sector and strengthen controls over U.S. funds that enter and leave Afghanistan. The Department's mission in Afghanistan is to support the broader U.S. civilian and military mission of disrupting, dismantling, and defeating al-Qaeda in Afghanistan and Pakistan and its extremist allies who threaten the security of the U.S. Homeland. DHS is fulfilling this mission by providing border, customs, investigative, and immigration expertise to the Afghan Border Police (Afghan Customs Department, Afghan Ministry of Transportation and Civil Aviation), the Afghan Ministry of Interior-Criminal Investigation Division, and the Afghan Ministry of Finance in order to help them:

- 1) deny terrorists illicit funding and illicit contraband sources;
- 2) enforce a secure border;
- 3) increase revenue flows to the Afghan government; and
- 4) improve cross-border commerce and facilitate legitimate trade and travel.

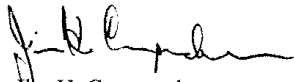
The DHS mission is aligned with the Integrated Civilian-Military Campaign Plan, which works to reduce the infiltration of insurgents and illicit goods and improve cross-border trade. DHS

ultimately seeks to transition responsibility for these duties to the Afghan government as its capacities grow.

Although the report does not contain any recommendations specifically directed at DHS, the Department remains committed to continuing its work with interagency partners, such as the U.S. Department of Treasury, and other relevant stakeholders in minimizing terrorist threats in Afghanistan, and in particular the threats posed by bulk cash smuggling.

Again, thank you for the opportunity to review and comment on this draft report. Technical and sensitivity comments were provided under separate cover. We look forward to working with you on future Homeland Security issues.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jan H. Crumpacker', with a stylized, flowing script.

Jan H. Crumpacker

Director


Departmental GAO/OIG Liaison Office



USAID | AFGHANISTAN

MEMORANDUM

TO: Monica Brym, Assistant IG for Forward Operations/Deputy Assistant IG for Audits
Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR)

FROM: S. Ken Yamashita, Mission Director 

DATE: July 6, 2011

SUBJECT: Draft SIGAR Report "Limited Interagency Cooperation and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash" (SIGAR Audit 11-13)

REF: SIGAR Transmittal email dated 6/13/2011

Thank you for providing the Mission with the opportunity to review the draft report on the subject audit. Discussed below are the Mission's comments on the recommendations and contents of the report.


PART I: COMMENTS ON SIGAR RECOMMENDATIONS

Recommendations 1 - 2:

To help leverage available resources and expertise and avoid duplication of agency efforts on financial sector issues, the U.S. Ambassador to Afghanistan should instruct the members of the Financial Sector Working Group to:

1. *Include DHS in their planning meetings and ensure that all U.S. agencies that support the development and strengthening of the Afghan financial sector be included in Financial Sector Working Group discussions, and;*

USAID Comments: As of June 5, 2011, international donors, implementing partners, and USG entities, including DHS, have been invited to participate in discussions of the Financial Sector Working Group.

2. *Develop an interagency strategy to coordinate efforts to work with Afghan banks to increase their EFT processing capabilities* 

USAID Comments: Accomplishing this task is not simply a unilateral, USG interagency effort. It requires the consensus and contribution of the Islamic Republic of Afghanistan (GIROA) and other donors. Working through the Financial Sector Working Group, the U.S. Mission to Afghanistan agrees to

U.S. Agency for International Development
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<http://afghanistan.usaid.gov>

seek to obtain consensus for, and a commitment to contribute to, the development of a donor-supported, GIRoA-owned strategy to increase EFT processing capabilities and to install bulk currency counters at banks in Afghanistan.

Recommendations 3 - 5:

To strengthen oversight over the flow of U.S. funds through the Afghan economy and to support overall U.S. reconstruction goals in Afghanistan, the Secretary of State and the Secretary of Defense should instruct their contracting and financial execution authorities to:

3. *Institute steps to record the serial numbers of cash disbursed to contractors and provide that data to U.S. law enforcement officials (including the Afghan Threat Finance Cell), as well as FinTRACA or another appropriate Afghan source;*

USAID Comments: As noted in the draft report, USAID does not make cash payments to our contractors and grantees. Payments are made via EFT through U.S. Disbursing Offices in Bangkok and Kansas.

4. *Develop a plan to ensure that Afghan banks that provide payments to recipients of U.S. EFT payments are able to record the serial numbers of cash paid to these recipients by using bulk currency counters and that these data are reported to U.S. law enforcement officials (including the Afghan Threat Finance Cell), as well as FinTRACA or another appropriate Afghan source, and;*

USAID Comments: We question the actual utility of this recommendation and note that it is not possible for the USG to unilaterally impose a requirement on Afghan banks to record serial numbers on cash disbursed to recipients of U.S. EFT payments by using bulk currency counters. Please see our response to recommendation 2, which reflects agreement to seek to obtain consensus for, and a commitment to contribute to, the development of a donor-supported, GIRoA-owned strategy to increase EFT processing capabilities and to install bulk currency counters at banks in Afghanistan.

5. *Insert a standard clause into U.S. contracts, grants, and cooperative agreements with entities operating in Afghanistan requiring that these contractors pay their subcontractors through either an EFT-capable bank or a licensed hawala, where possible. Alternatively, if a determination is made that inserting such a clause would not be feasible under existing regulations, submit a formal proposal to Congress with legislative language allowing the inclusion of such a clause.*

USAID Comments: As indicated in the draft report, USAID itself pays our implementing partners through EFT (with the exception of petty cash purchases). Of course, we agree that where our implementing partners have the ability to make payments through EFT, this approach helps to safeguard U.S. funds. We do not agree with the recommendation to introduce a new

requirement into our awards to require that our implementing partners make payments through EFT or licensed hawalas solely.

Many of our implementing partners, particularly those who work in remote areas, simply do not have access to banks that provide EFT services. We further believe there are alternatives to using licensed hawalas, such as checks and mobile banking that better safeguard USG funds. USAID encourages our implementing partners to use lawful, readily available, and reliable vehicles to make payments under USAID-funded awards, including EFT, check, licensed hawalas, and mobile banking.

Additionally, the USAID report entitled *Accountable Assistance for Afghanistan (A3)* recommends our Implementing Partners “electronically transfer project funds to any subcontractors, when the financial infrastructure exists to do so.” As an additional safeguard, the A3 also recommends the Mission initiate a 100% locally incurred cost-audit program. The Mission has accepted this recommendation and has initiated steps to implement.

It should also be noted that OIG/Afghanistan, in its Review Report No. F-306-11-002-S dated March 7, 2011, “found that the cash disbursement practices of the ten selected USAID/Afghanistan implementing partners reasonably ensured that their cash expenditures were reasonable, allocable, and allowable”. OIG recommended that the Mission disseminate to its implementing partners the best practices described in the report (including EFT or check payment to local vendors and subcontractors). The Mission complied with the OIG recommendation through the issuance of a letter on 2/17/2011 to its implementing partners. The Mission’s implementing partners are therefore fully aware of controls that are needed to ensure that USG funds are properly safeguarded.

(This report was conducted under the audit project code SIGAR-036A).

SIGAR's Mission	<p>The mission of the Special Inspector General for Afghanistan Reconstruction (SIGAR) is to enhance oversight of programs for the reconstruction of Afghanistan by conducting independent and objective audits, inspections, and investigations on the use of taxpayer dollars and related funds. SIGAR works to provide accurate and balanced information, evaluations, analysis, and recommendations to help the U.S. Congress, U.S. agencies, and other decision-makers to make informed oversight, policy, and funding decisions to:</p> <ul style="list-style-type: none"> • improve effectiveness of the overall reconstruction strategy and its component programs; • improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors; • improve contracting and contract management processes; • prevent fraud, waste, and abuse; and • advance U.S. interests in reconstructing Afghanistan.
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Public Affairs	<p>Public Affairs Officer</p> <ul style="list-style-type: none"> • Phone: 703-602-8742 • Email: PublicAffairs@sigar.mil • Mail: SIGAR Public Affairs 400 Army Navy Drive Arlington, VA 22202